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No. 715

IN THE

Supreme Court of the United States

THE ARKANSAS CORPORATION COMMISSION, and Fifty-One County Tax Collectors of Arkansas ..... Petitioners and Appellants Below

Vs.

GUY A. THOMPSON, as Trustee of Missouri Pacific Railroad Company, Debtor ..... Respondent and Appellant Below

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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INDEX

TABLE OF CASES CITED

AUTHORITIES CITED

SPECIFICATIONS OF ERRORS ARGUED AND AUTHORITIES

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

The questions discussed in the opinion of the Circuit Court of Appeals will be presented in their order.

1.

THE ST. FRANCIS LEVEE DISTRICT CASES

The opinion is based primarily on the earlier decisions of that court in the St. Francis Levee District cases, the first of which was St. Francis Levee District v. Kurn, 91 Fed. (2) 118 and the last St. Francis Levee District v. Kurn, 98 Fed. (2) 394. It is of no interest now whether these cases were correctly decided or not. They are not a proper basis for this decision.

The first case was an appeal from an interlocutory injunction granted by the United States District Court for the Eastern District of Arkansas in a suit therein brought by the Trustee against the District which involved foreclosure suits brought by the District against the Trustee. The second was an appeal from an order of the Bankruptcy Court in St. Louis requiring the district to file its claims therein on or before a specified date or be barred and enjoining other foreclosure suits which had been brought since the first suit. These suits did not involve any actions of the State Board nor any taxes imposed by the State or its political subdivisions. The court held in these cases that the District was not a civil or political agency of the State, that it was a mere quasi public corporation like a railroad. There was no statutory remedy for a judicial review of the assessments made by the Board, the only provision was for an administrative review which was discussed fully by the court in St. Francis Levee District v. the Frisco Railroad, 74 Fed. (2), 186.

The District Court in this case followed these cases as binding upon it, and an interesting article reviewing the decision of the District Court is found in the Yale Law Journal of the November 1940 issue, entitled: "Jurisdiction of a Federal Bankruptcy Court to Rule on State Taxes." Furthermore, these cases were decided before this court rendered its decisions in the cases of Palmer v. Massachusetts, 308 U. S. 79, Railroad Commission v. Rowan and Nichols Oil Company, 310 U. S. 573, and Nashville and Chattanooga, etc., Railroad v. Browning, 310 U. S. 362.

2.

POWERS OF BANKRUPTCY COURT

In Palmer v. Massachusetts, 308 U. S. 79, this court held that the whole scheme of Section 77 left no doubt that Congress did not mean to grant to the District Courts the same scope as to bankrupt roads that they may have in dealing with other bankrupt estates and that it would violate the traditional respect of Congress for local interests and for the administrative process to imply a power in a single judge to disregard State law over local activities of a carrier.

The Court further in rejecting an argument of an implied power in Section 77 for supplanting State agencies, referred in a note to the difference between "physical invasion" and supplanting other remedies and stated that Congress did not intend that those who operate a business under control of a Federal Court should be immune from regulatory authority of the several States any more than they are from their taxing power.

In the face of this decision the opinion herein admits its effect will be, in respect to railroads in reorganization proceedings, to restrict the States in the exercise of their gen-

eral and customary sovereign powers in respect to the collection of taxes assessed against property within their borders.

The only power which Congress gave to these courts under Section 77 not vested in them under other bankruptcy proceedings, was as follows: "Process of the court shall extend to and be valid when served in any judicial district." (Section a.)

The reason for this was fully explained by this court in Continental Ill. N. B. & T. Co. v. C. R. I. & P. R. Co., 294 U. S. 648, wherein it was pointed out that under Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, it was necessary to have an ancillary bankruptcy proceeding in every district where property of the bankrupt existed outside of his domicile.

This matter is discussed fully in Thompson v. Terminal Shares 104 Fed (2d) 1, by the Circuit Court of Appeals of the Eighth Circuit. It stated: "That provision is more procedural than jurisdictional."

The opinion therein refers to section 51 of the Judicial Code as relating to requirements that no civil suit shall be brought in any district against any person other than the district wherein he is an inhabitant, and also section 23 of the Bankruptcy Act as indicating that the continued resolve of Congress that a person should not be subject to civil suits except in the district in which they are inhabitants.

Section 23 has two sections. Section a relates to adverse suits. Section b provides that suits by a receiver or trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this act had not been instituted.

The Circuit Court of Appeals thus concluded: "The language used by Congress in Section 77, in conferring jurisdiction upon the courts of bankruptcy, does not, in our opinion, indicate any intention to abandon that policy with respect to such suits as this."

The position of these petitioners cannot be better stated than was thus stated by the Circuit Court of Appeals in that case, to-wit:

> "Unquestionably, the claim of the trustee of the Missouri Pacific Railroad Company for an accounting and for the enforcement of the equitable lien asserted in an asset of the trust estate and as such is under the jurisdiction and control of the court of bankruptcy. The property upon which the lien is claimed and the persons of those who possess the property or have claims against it are not within the jurisdiction or under the control of the court of bankruptcy. The power of that court to preserve and safeguard the claim of the trustee does not carry with it the power to adjudicate his controversy with adverse and non-consenting defendants."

Now that same court speaking through different Judges authorized the Bankruptcy Court in St. Louis to send its process to the Corporation Commission of Arkansas, the Attorney General of Arkansas and 51 County Collectors of taxes in Arkansas and have them answer in said Bankruptcy Court in Missouri as to the validity and amount of taxes assessed by the Corporation Commission of Arkansas acting under statutes giving notice of hearing before action was taken by the Corporation Commission, and said statutes provide for any aggrieved taxpayer to carry his grievance to the Circuit Court at the seat of government clothed with complete authority to grant a speedy review

of the grievance and protect the parties' rights in the interim.

That same court has announced, applied and followed the following sound principles:

> "When a state provides a tribunal for the hearing of complaints against assessments, such tribunal has exclusive jurisdiction."
>
> McLaughlin v. St. Louis & Southwestern Ry. 232 Fed. 579; Missouri Pacific Railroad Co. v. Conway & Vilonia Road District., 280 Fed. 401.

The opinion herein quotes from Kalb v. Feuerstein, 308 U. S. 433 on the authority of the Constitution to grant Congress exclusive power. In fact, the right of Congress to limit the jurisdiction of the District Courts where the state affords a speedy and efficient remedy for the alleged grievance and where it provides that the suit shall not be brought by a trustee other than in such courts as the bankrupt could have brought them, are limitations on bankruptcy courts and just as valid as the power of jurisdiction granted them would be.

The court further states that it is vitally necessary that the Bankruptcy Court to which reorganization of railroads is conferred by section 77, should be empowered to determine the validity and amount of all liens against the railroad property, and to marshal them to accomplish the purpose of reorganization proceedings.

The complete answer to that proposition is found in Thompson v. Terminal Shares, 104 Fed. (2d) 1, as follows:

> "The inquiry here, however, is not as to what Congress might have done, but as to what it actually did with respect to the jurisdiction of the bankruptcy courts in enacting and amending Section 77."

And it is submitted that this court has so far failed to find the power vested under section 77 in the Bankruptcy Court, which this Bankruptcy Court exerted in this instance.

3.

SECTION 64a IS INCONSISTENT AND NOT PART OF SECTION 77.

The court decided that Section 64a of the general Bankruptcy Act is applicable to proceedings under Section 77 thereof. Subdivision 1 of Section 77 provides that in all proceedings under it and consistent with its provisions, the jurisdiction and powers of the court etc., shall be the same as if a voluntary petition and adjudication had been had.

Finletter on Bankruptcy Reorganization, page 344, states:

> "Section 77 makes no direct reference to Section 64, providing merely that "in proceedings under this section and consistent with the provisions thereof" the rights of creditors shall be the same as if a voluntary petition for adjudication had been filed and a decree entered thereon. This provision is sufficient, it is believed, to exclude Section 64 from application to proceedings under Section 77, for the scheme of Section 64 is inconsistent with the Railroad Act. The priorities which Section 64 establishes are those designed for ordinary bankruptcy, that is for a proceeding affecting unsecured debts only. They are not intended or appropriate for a proceeding which disturbs secured debts as well, and it was for this reason that Section 64 was excluded from application under Chapter X. Any reorganization proceeding which deals with secured debts must have a hierarchy of priorities which will put certain classes (such as administrative expenses)

ahead of the secured creditors, and Section 64 does not do so. It provides only for the "debts to have priority, in advance of the payment of dividends to (unsecured) creditors." Further there appears in Section 64 itself, by its references to arrangements and wage-earners' plans and its failure to refer to plans of reorganization (the term which would have been used had it been intended to refer to Section 77) an intention that its provisions shall not apply under the Railroad Act."

A review of some of the pertinent provisions of Section 77 (Title 11, Section 205, U. S. C. A.) shows the soundness of the above statement. The Judge shall require the Trustee to prepare and file with the Court in lieu of schedules as required in general bankruptcy, a list of bondholders and creditors, amount and character of the debts, securities etc., and a list of all stockholders. (c) (4). The Judge shall fix a reasonable time within which claims of creditors may be filed or evidenced and after which time no claim not filed or so evidenced may participate in the proceedings with an exception stated. Then after notice and hearing a division is made by the Court of creditors and stockholders into classes according to the nature of their respective claims and interests. "Such division shall not provide for separate classification unless there be substantial differences in priorities, claims and interests." (c) (7). Under the general act Section 57 prescribes a method of proof of claims, while Section 77 leaves to the judge the methods of requiring their evidence, and Section 57 further provides details for the allowance of claims, secured and unsecured. The proceedings under Section 77 is merely to ascertain the amount and classifications of claims in order to determine who may participate in the reorganization plan and vote thereupon.

Section 60 of the General Act provides for preferred creditors and their rights which cannot be pertinent in reorganization proceedings for the plan of reorganization covers that field.

Thereafter comes Section 64 dealing with debts which have priority in advance of dividends and establishing the order of their priorities. A Procrustean bed unfitted for reorganization. Section 64 deals entirely with the payment of the unsecured debts of the bankrupt. Its sole purpose is to give priority to certain of such debts over the payment of dividends to general creditors. In Re: Brannon 62 Fed. (2d) 959. (CCA5).

Section 77 does not contemplate the payment of debts at all, except as payments may be provided in the plan of reorganization in which their priorities are determined by the agreement, to be approved by the Interstate Commerce Commission and by the stockholders and creditors and confirmed by the Court.

The payment of debts as in ordinary bankruptcy is foreign to reorganization proceedings. Reorganization does not contemplate a sale by the court of any of the debtor's property for the purpose of paying the bankrupt's debts. Thompson v. The State of Louisiana, 98 Fed. (2d) 108. (CCA 8).

The cardinal purpose of Section 77 is to prevent a sale of the debtor's property and to guarantee its continued operation, while the ultimate end of all bankruptcy proceedings is the sale and disposal of all the property of the debtor and the payment of all debts so far as may be realized from such sales.

Section 64a is only intended to apply to proceedings where liquidation is contemplated. It has no other office

or purpose and liquidation can never occur under Section 77.

It is respectfully submitted that the Court was in error in holding that Section 64a was applicable to proceedings under Section 77.

4.

SECTION 64a NOT APPLICABLE TO TRUSTEES' TAXES.

There have been several minor changes in section 64, which is the section of the Bankruptcy Act establishing which debts have priority, but in its final form as now existing, so far as applicable here, reads as follows:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition. • • •
>
> "(4) Taxes legally due and owing by the bankrupt to the United States or any States or any subdivision thereof•••
>
> And provided further, that, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court."

The opinion holds the words "any taxes" used in paragraph 4 is not restricted to the bankrupt's taxes, but is applicable to the trustee's taxes also.

The same court in Hennepin County v. M. W. Savage Factories, 83 Fed. (2d) 453, a case originating under Section 77b and converted into a general bankruptcy proceeding said:

"The amendment of section 64a of the Bankruptcy Act (11 U. S. C. A. Sec. 104)—assuming that the law is relevant to the case at bar—does not touch the payment of taxes accruing during the trustee's possession."

That opinion, after reviewing decisions of two other Circuit Courts of Appeals, to the effect that 64a was not applicable to trustee's taxes in reorganization proceedings said:

"That seems to be a reasonable and sensible interpretation, since such taxes are not in a true sense taxes "due and owing by the bankrupt," but are ordinary carrying charges of property taken over and used by the trustees under order of the court in the conduct of their own operations and for the benefit of general creditors."

Under the decision here, taxes which are operating expenses are no longer in a class of operating expenses, but deferred to the fourth priority, a construction that would materially affect operation of properties in reorganization proceedings. However, a review of the general bankruptcy act makes the construction of the court here untenable.

In Boteler v. Ingels, 308 U. S. 57, the court stated:

"And 57 (a) makes clear that section 57 as a whole relates only to claims 'justly owing from the bankrupt to the creditor.' "

Subdivision (j) of said section 57 prohibits allowances against the bankrupt's estate of debts owing to the United States or any State or subdivision thereof as a penalty or a forfeiture, except for the amount of pecuniary loss sustained by the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable cost and interest.

Therefore, when tax penalties accrue, which is usual in bankrupt estates or forfeitures were claimed, it was necessary that the court cut out so much thereof as was penalty or forfeiture and allow the actual pecuniary loss sustained by the act or omission of the debtor. Hence, it followed that in providing for taxes due the United States or any State or subdivision thereof, that questions would arise as to whether penalties or forfeitures were included and, therefore, paragraph 4 contained the language giving the court authority to find the amount and legality of the taxes of the bankrupt or in the event of forfeitures or penalties, the loss accruing therefrom, rather than the penalty or forfeiture. This provision links with subdivision (j).

In Boteler v. Ingels, supra, the court had the question whether trustee's taxes in a reorganization proceeding was subject to penalties and held that they were, but that the bankrupt's taxes were not. In the decision the court referred to the Act of June 18, 1934, 48 Statutes at Large, p. 993, to the effect that a trustee shall be subject to all State and local taxes applicable to the business the same as if conducted by an individual or corporation. The court stated that this act indicated a Congressional purpose to facilitate, not to obstruct enforcement of State laws. Yet, the court's opinion here declares that State laws for collection of taxes assessed against property therein which is in reorganization proceedings in another State are silent pending such proceedings. The court held in this case that the taxes and penalties in issue were incurred by the trustee while operating the bankrupt's business and were not owed by the bankrupt and that regardless of other rights a State might have it could not file proof of claim for these taxes and penalties as a creditor under Section 57 of the Bankruptcy Act as it only applied to the debts of the debtor and not of his trustee.

5.

THE ORDER OF APRIL 11, 1940 WAS AN INJUNCTION.

The court in the opinion here declares that the order referred to was not an injunction within the meaning of the Johnson Act of 1934, 41 Statutes at Large, 775 (U. S. C. A. Title 28, Section 41). It was the duty of the trustee to pay these taxes because they were duly levied and assessed and without such order these taxes would have been paid by him. This order arrested the payment of 40% of the taxes assessed and levied in the hands of the collectors for collection amounting to $416,043.71. The property being in the hands of the bankruptcy court prevented the collectors proceeding under the statutes to collect these taxes as they would have been required to have done under the law had not this order been issued. This order directed the trustee to hold in his hand said amount and practically operated as an injunction against the collectors' proceeding under the statute until the court in bankruptcy in St. Louis heard and determined the amount and validity of the taxes. This was an exercise of equity jurisdiction, operating in personam, requiring the trustee to do or refrain from doing the particular thing. Where a stay of proceeding is ordered or effectuated, it makes no difference whether the matter is pending in the same court or a different court or stopping a statutory proceeding. The essential element is an exercise of the equitable principle. The use of the words "refrain or enjoin" are not necessary words. It is the effect of the order, not its language which is to be considered.

Justice Van Devanter, then Circuit Judge, speaking for the Circuit Court of Appeals of the 8th Circuit, in Griesa v. Mutual Life Insurance Company, 165 Fed. 48, declared such orders as this one an injunction within the meaning of the

statutes referred to. Later, through Judge Walter H. Sanborn, this same court approved and applied Justice Van Devanter's opinion. Western Union Telegraph Co., v. U. S. & M. T. Co., 221 Fed. 543. This court has applied the same principle in Enelow v. New York Life Ins. Co., 292 U. S. 379. The court answered the petitioner's contentions that this order was a violation of the tax statute of 1937, now a part of 24 Judicial Code (U. S. C. A. Title 28, Sec. 41) in the same way, namely, that this was not an injunction and, hence, it was immaterial that a plain, speedy and efficient remedy was provided by the statutes of the State for a judicial review in the courts of the State of the matters complained of in regard to the assessment. This Act was invoked in the St. Francis Levee District case, 98 Fed. (2d) 394, where it was held inapplicable, and properly so, for the taxes involved there were not taxes imposed by the laws of the State, but were imposed by mere local agency of the landowners and as was therein held this district was not a civil or political subdivision of the State, but a mere quasi public corporation.

6.

NON-JUSTICIABLE ISSUE

The opinion summarizes the allegations of the petition as to the issue presented therein which have been set forth in the statement of the case in the petition for certiorari. Then the court holds that it cannot say that these allegations are so entirely lacking in elements of fact that it does not raise the question as to the amount and legality of the taxes within the meaning of Section 64a. The petitioners' contention is that giving full sweep to the allegation of the wrongful method of making the assessment of the system value, yet it does not present a justiciable issue for judicial review in a State or Federal court. Each factor alleged

to have been used by the Commission is a factor commonly employed by courts and commissions in establishing value.

These various factors which were referred to in various decisions are considered in a Government Publication entitled: "Public Aids to Transportation," which was written by Charles S. Morgan, Director, Coordinator's Section of Research, in which there is found this statement in volume 2, at page 200:

> "The different state assessing bodies use different methods of valuation. Few, if any, State boards confine themselves to only one formula for valuation, the great majority using combinations of two or more. The better known formulas are so-called physical valuation, cost of reproduction new less depreciation, original cost, book value, gross receipts, market value of stocks and bonds, and capitalization of net income."

Then the author proceeds to show weakness in each of the factors, particularly if used alone, and concludes the discussion as follows:

> "These criticisms are essentially sound, but they can be overcome in large measure by a valuation method which employs a combination of two or more formulae. Further, the operation of valuation methods is not confined to the bare outlines mentioned, but in some instances involves consideration of average income, stock and bond prices, or physical valuations over a period of years. Irregularities are thus to some extent ironed out."

It is thoroughly settled by this court that evidentiary weight is a matter solely for the administrative board and is not a subject of judicial review. The last word is Rail-

road Commission v. Rowan & Nichols Oil Company, 310 U. S. 573 (Advance Opinion). Applying the same principles:

Federal Communication Commission v. Pottsville Broadcasing Co., 309 U. S. 134;

Nashville & Chatanooga, etc., v. Browning Adv. Opinion, 310 U. S. 362;

Great Northern Ry. Co., v. Weeks, 297 U. S. 135;

Rowley v. Chi. & N. W. R. R. 293 U. S. 102.

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